COMPANY RESEARCH AND ANALYSIS REPORT

create restaurants holdings inc.

3387

Tokyo Stock Exchange First Section

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Index

Summary

Results slumped substantially in FY2/21 due to the COVID-19 pandemic
Though some success in strengthening the income structure and improving the financial foundation
Intends to work on developing core capabilities to support renewed growth for the time being

1. Company profile

create restaurants holdings inc. <3387> (hereafter, also “the Company”) focuses mainly on the operation of restaurants and food courts inside shopping centers, while also developing izakaya (traditional Japanese eating and drinking establishments) and restaurant formats acquired through M&A. One characteristic is that the Company carefully selects locations that attract large numbers of customers, and employs a distinctive multi-brand, multi-location strategy, which involves developing a variety of restaurant formats attuned to specific locations (regional characteristics, customer attributes, competition status, etc.). This strategy has supported the Company’s main business. The Company had 1,076 outlets* in about 250 brands as of the end of FY2/21. Additionally, it promoted Group Federation Management that pursues growth in business areas with growth potential through proactive M&A deals in recent years. While impact from the COVID-19 pandemic is weighing on the restaurant industry, the Company aims to achieve prompt recovery and respond to changes in the environment by bolstering the income structure with rigorous cost controls.

* Including all business consignment outlets and franchise outlets (same below)

2. FY2/21 results

The Company reported FY2/21 results (IFRS standards) with ¥74,425mn in revenue (-46.6% YoY) and a ¥14,181mn operating loss, slumping significantly due to COVID-19 impact. Nevertheless, it booked ¥5,130mn in adjusted EBITDA, a key indicator. Revenue dropped sharply in all categories due to repeated implementation of suspensions and shorter business hours related to the pandemic. Results fell substantially in 1Q because of the uniform suspensions and shortened business hours during the first state of emergency declaration. Activity recovered temporarily from 2Q thanks to incremental resumption of normal operations and return of customer traffic, but partial suspensions and shortened business hours related to the third COVID-19 wave caused a slowdown in 4Q. In income, even though the Company implemented rigorous cutbacks in fixed costs (reducing personnel expenses, negotiating rent reductions and exemptions, etc.), it posted a massive operating loss because of a heavy fixed cost burden amid sharp decline in revenue. Meanwhile, it had some success in reinforcing the income structure with rigorous fixed cost reductions (lowering the breakeven point) and improving the financial foundation with perpetual subordinated loans (booked in capital).

3. FY2/22 guidance

In FY2/22 guidance, the Company targets ¥115,000mn in revenue (+54.5% YoY) and ¥4,600mn in operating profit. It expects profitability at all income levels driven by recovery in revenue. Furthermore, it anticipates strong recovery in adjusted EBITDA to ¥22,000mn. Despite a difficult start in 1Q due to the third state of emergency declaration, the Company forecasts moderate recovery in revenue from 2Q. Due to lifestyle changes, however, it assumes that consumption behavior should not fully return to the same level as previously and projects real same-store sales for the full year at 76.4% of the level prior to the pandemic (FY2/20). In income, it intends to cover losses from 1Q, which is facing difficult conditions, with employment adjustment subsidies and funds from local governments for cooperating with shortened business hours and build operations capable of generating profits even with moderate recovery in revenue through conversion to a lean income structure via continued rigorous cost controls and cutbacks in rent and other fixed costs.

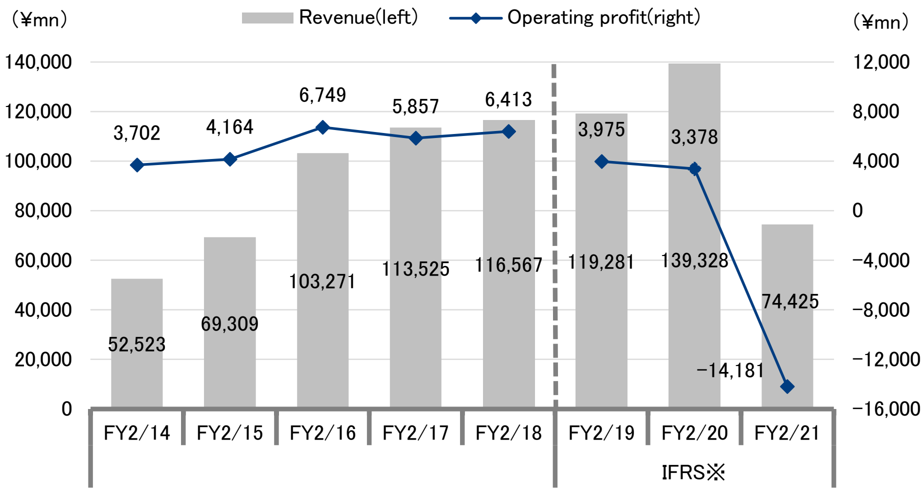
4. Direction

The Company announced the transition to a new management structure along with a change in the President on April 1, 2021 (it will officially approve the new framework at the ordinary general meeting of shareholders held in May 2021). After progress in conversion to a lean cost structure and improving the financial foundation, it wants to address the response to changes in the overall environment (new normal) with new operations. Additionally, while the Company previously disclosed a three-year medium-term management plan annually, it postponed disclosure this time because of uncertainty about the COVID-19 pandemic impact. It should announce the future management policy and other points following the official start of the new framework. For the time being, meanwhile, it appears to be largely sticking with the stance of assessing the content and timing of investments seeking renewed growth from FY2/23 once it has strengthened core profitability and developed its foundation.

Key Points

- Results slumped substantially in FY2/21 due to the COVID-19 pandemic
- Though some success in strengthening the income structure and improving the financial foundation with perpetual subordinated loans
- Guides for profits in FY2/22 driven by ongoing measures to strengthen profitability
- Intends to assess the content and timing of investments seeking renewed growth from FY2/23 after strengthening core profitability and developing its foundation for the time being

Results trends



* Adopted IFRS from FY2/19
Source: Prepared by FISCO form the Company's financial results

Company profile

Implements "Group Federation Management" that pursues a variety of brands utilizing aggressive M&A

1. Business description

The Company mainly have operated restaurants and food courts at shopping centers and has moved into izakaya and other type restaurants acquired through M&A. As a holding company, it brings together 21 consolidated subsidiaries (including 5 overseas companies) (as of the end of FY2/21).

The Company carefully selects locations that attract large numbers of customers, and employs a distinctive multi-brand, multi-location strategy, which involves developing a variety of restaurant brands attuned to specific locations (regional characteristics, customer attributes, and competition status, etc.). This strategy has supported the Company's main business. Further, in recent years, the Company is promoting "Group Federation Management," which involves incorporating various brands with high growth potential into the Company through aggressive M&A activities. As of the end of February 2021, the Company has 1,076 restaurants in approximately 250 brands.

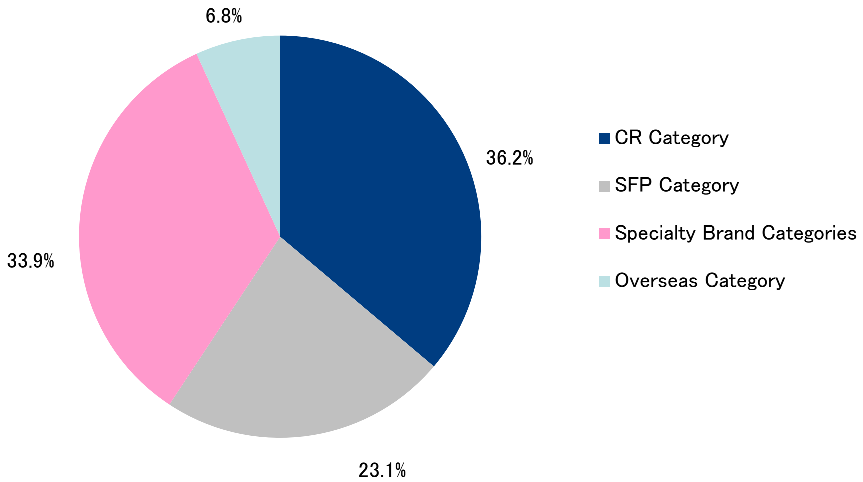
Overview of business categories (as of the end of February 2021)

CR Category	It is comprised of the outlets operated by create restaurants (CR), Create Dining (CD), and create sports and leisure (SL). There were 553 outlets at the end of February 2021. The main brands include Harvest, shabu SAI, Rio Grande Grill, Roast Beef Hoshi, and Desert Okoku.
SFP Category	This business consists of stores operated by SFP Dining (now, SFP Holdings) (SFP) with which it formed a capital alliance in April 2013. It operates izakaya outlets in urban downtown districts. The Company aims to enter regional core cities with a unique alliance concept. There were 227 outlets at the end of February 2021. Main business formats at seafood izakaya ISOMARU SUISAN, fried chicken wing specialty restaurant Toriyoshi and Toriyoshi Shoten, gyoza (dumpling) izakaya Ichigoro, and Japanese-style pub Go-no-Go.
Specialty Brand Categories	This business consists of KR Holdings (KR), LG&EW (LGEW), YUNARI (YNR), Gourmet Brands Company (GBC), Route 9g (RN), YUZURU (YZ), and ICCHOU (IC). It is mainly focusing on Kagonoya, ICCHOU and Gomasoba YUZURU outlets for roadside locations, developing their respective specialty brands for urban commercial facilities. There were 243 outlets in total at the end of February 2021. The main brands include Japanese restaurants Kagonoya and ICCHOU, Italian restaurants TANTO TANTO, primarily vegetable based Italian restaurants AW kitchen, Tsukemen TETSU, Café Boulangerie JEAN FRANÇOIS, Singaporean cuisine Hainan Jeefan Restaurants, Gomasoba YUZURU.
Overseas Category	It is comprised of restaurants operated by the Company's overseas subsidiaries in Singapore, Hong Kong, Taiwan, and the United States. There were 53 outlets in total at the end of February 2021. The main brands include shabu SAI and MACCHA HOUSE, an outlet specializing in matcha green tea. In North America, the Company operates Japanese restaurants, including SOBA TOTTO and Italian restaurant Il Fornaio.

Source: Prepared by FISCO from the Company's results supplemental briefing materials and interviews

The Company's businesses are divided into four categories: (1) the CR Category, involving the operation of restaurants and food courts with multiple brands mainly at commercial facilities, (2) the SFP Category, involving the operation of izakaya brands, (3) the Specialty Brands Category, involving the operation of various restaurant brands, and (4) the Overseas Category, which involves operation of restaurants in Singapore, Hong Kong, the United States, and so forth.

Revenue by category (FY2/21 results)

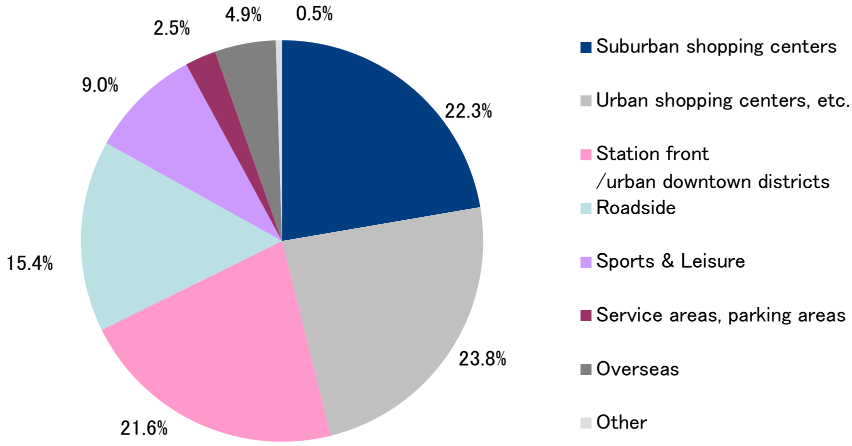


Source: Prepared by FISCO from the Company's results supplemental briefing materials

Further, the breakdown of restaurant numbers by location shows 22.3% for suburban SC, 23.8% for urban SC, 21.6% for station front and urban downtown districts, 15.4% for roadside, 9.0% in Sports & Leisure*1, 2.5% for SA/PA (Service areas, parking areas)*2, and 4.9% overseas; having achieved a good, balanced distribution from the previous concentration in commercial facilities (as of the end of FY2/21).

*1 Consignment operation of restaurants at golf course and theme parks, etc.
*2 Consignment operation of stores in highway service areas and parking areas, etc.

Composition of restaurant numbers by location
(as of the end of February 2021)



Source: Prepared by FISCO from the Company's results supplemental briefing materials

2. History

The Company was established in 1997 as the Yokosuka Brewing Company K.K. (the company name was changed to create restaurants inc. in 1999) by Tokuju, K.K., the family business of the Company's current chairman, Hitoshi Gotoh. However, its actual foundation was in 1999, when it took over the operation of five western-style restaurants from Tokuju and started the restaurant business in earnest. In 2000, then employee of Mitsubishi Corporation <8058> (hereafter "Mitsubish") and previous representative director, president and CEO Haruhiko Okamoto engaged with the Company through an in-house venture scheme, with the Company also receiving a capital investment from Mitsubishi (the capital relationship with Mitsubishi was terminated in 2012). Thereafter, backed by Mitsubishi's reputation and other resources, the Company accelerated its growth by increasing its number of restaurants, mainly opening them in commercial facilities and similar locations. In 2005, the Company listed on Mothers market of the Tokyo Stock Exchange, Inc., changing to the First Section in 2013.

The Company has also been aggressive in M&A, acquiring the Japanese cuisine chain KISSHO in 2007 and shifting to a holding company structure in 2010 to establish a platform for "Group Federation Management." Subsequently, the Company has acquired LE MONDE DES GOURMET in 2012, SFP Dining*1 and eatwalk in 2013, YUNARI and Shanghai Bishoku Chushin Co., Ltd. (company name changed from R21 Cuisine) in 2014, KR Food Service*2 and RC Japan (now Create Dining inc.) in 2015, successively bring them into the Group. SFP Dining was listed on the TSE Second Section in December 2014 (a subsidiary listing). (Its listing was changed to the TSE 1st Section on February 28, 2019). The Company acquired Kiya Foods, Icchou, and other companies in 2019 through a number of M&A.

*1 SFP Dining Co., Ltd. changed its name to SFP Holdings Co., Ltd. in June 2017
*2 KR Food Service Co., Ltd., changed its name to KR Holdings Co., Ltd., in December 2018.

In overseas deployment, the Company started in 2008 by establishing a joint venture with a local company in Shanghai, and among other initiatives went on to establish wholly owned subsidiaries in mainland China in 2010, Singapore in 2011, Hong Kong in 2012, and Taiwan in 2014. While the Company's overseas expansion is still considered to be in the experimental stage, it is preparing the groundwork for a full-fledged expansion in the future. The Company established a subsidiary in New York for the purpose of developing US business in March 2016 and opened its first Japanese food outlet for North America in New York in July 2017. In September 2019, the Company added California-based Il Fornaio (America) LLC to the Group, its first major overseas acquisition. The Company completed the exit of all restaurants from China (Shanghai) at the end of August 2017.

Corporate characteristics

Possesses a strong brand portfolio with industry development capabilities and robust M&A results

1. Multi-brand, multi-location strategy

The characteristics of the Company's main business are 1) opening restaurants in commercial facilities that attract large numbers of customers (shopping centers, station buildings, etc.) and 2) operating diverse brands attuned to their local environments (regional characteristics and customer attributes, status of competition, etc.). The diversity of these brands, including Japanese, Western, and Chinese cuisine, as well as ethnic food and cafes, enables the Company to open multiple restaurants within a single commercial facility and respond to various needs of the facility owner (developer, etc.). This has worked to the Company's advantage in opening restaurants inside commercial facilities, which typically have a higher barrier to entry. Naturally, there is also a cost factor involved in creating multiple brands attuned to their local environments; however, the capacity to develop brands that use the customer drawing power of favorable locations to maximum advantage is the Company's true worth. The source of its value creation is accumulation of know-how in brand development and operations.

On the other hand, the seafood izakaya ISOMARU SUISAN, developed by SFP which was acquired in 2013, has as a special characteristic in its 24-hour operation in station-front locations populated with convenience stores and drugstores. In challenging fierce competition with street-level locations, the chain deliberately selected high-cost station-front sites due to its insistence on locations that attract large numbers of customers. This may be cited as one reason why the chain has a strong affinity with the strategy employed by the Company thus far. Therefore, it can be seen as an extension of the scope of the multi-location strategy to include the street-level domain, and it could pave the way for future full-scale development of diverse brands among street-level locations in urban downtown districts, in addition to the existing commercial facilities. Furthermore, Japanese restaurant chain Kagonoya, which is operated by KR Food Service acquired in 2015, has stores mainly in roadside locations, and contract business (handled by create sports & leisure), which was acquired in 2019, engages in consignment operation of restaurants at golf courses. The Company is reinforcing location diversity and brand specialization with robust M&A activities.

2. Growth model based on “Group Federation Management”

In addition to organic (internal) growth, the Company’s growth model is one where growth arises by supporting growth through engagement with high growth potential brands via M&A, creating various synergies and providing a platform (support from a funding and management perspective etc.). In the past, the Company expanded its operational base through operating restaurants in commercial facilities and food courts. However, given that it was a growth model that was readily influenced by the commercial facility’s circumstances, along with the shift to a holding company structure, the Company sought to transition to a strategy that aims for autonomous growth via “Group Federation Management.” Understandably, it is recognized the Company succeeded because it had been established from an internal Mitsubishi Corporation venture. Additionally, it was a management style familiar in terms of management resources (with staff etc. that were skilled in business management) and corporate cultural perspective. Furthermore, it was recognized as a partner with which a relationship could be readily formed, and done so with relatively little resistance from capital tie-up partners. M&A and maximization of group synergies are important themes for the future growth strategy. The Company’s distinctive growth model clearly has advantages in a difficult industry environment, including shrinkage of the domestic market and manpower shortages.

Financial results

Realizing high growth potential and profitability through aggressive additions including M&A

1. “Group Federation Management” progress and results trends

Looking back at results prior to the COVID-19 pandemic (up until FY2/20), expansion of outlet volume with new openings and M&A deals fueled growth in earnings. In particular, the turning point was from FY2/13 with a shift to a new growth strategy through “Group Federation Management.” By realizing high growth potential through bringing a range of formats with growth potential into the Group, while supporting further additions, the Company sought to enhance location diversity and specialty branding. However, the number of outlets shrunk in FY2/21 due to extensive closures of unprofitable outlets affected by the pandemic. Trends in the composition of outlet volume by locations show commercial facilities (total of suburban SCs and urban SCs) dropped from 78.4% at the end of FY2/12 to 46.1% at the end of FY2/21 and diversification to sites by train stations and in shopping districts (21.6%), roadside sites (15.4%), and sports and leisure sites (9.0%). The Company established a balanced location portfolio during these years.

Openings and closings (including M&A) and total at the end of period

	New openings	Closures	Acquired via M&A	Total at the end of the period
FY2/15	102	42	26	616
FY2/16	108	38	109	795
FY2/17	116	54	0	857
FY2/18	68	62	2	865
FY2/19	60	29	29	925
FY2/20	43	56	238	1,149
FY2/21	68	143	1	1,076

Note: From FY2/15, total at the end of the period includes restaurants where outsourced operations are provided, FC locations, non-consolidated locations and overseas J/V locations.
Source: Prepared by FISCO from Company materials

M&A track record

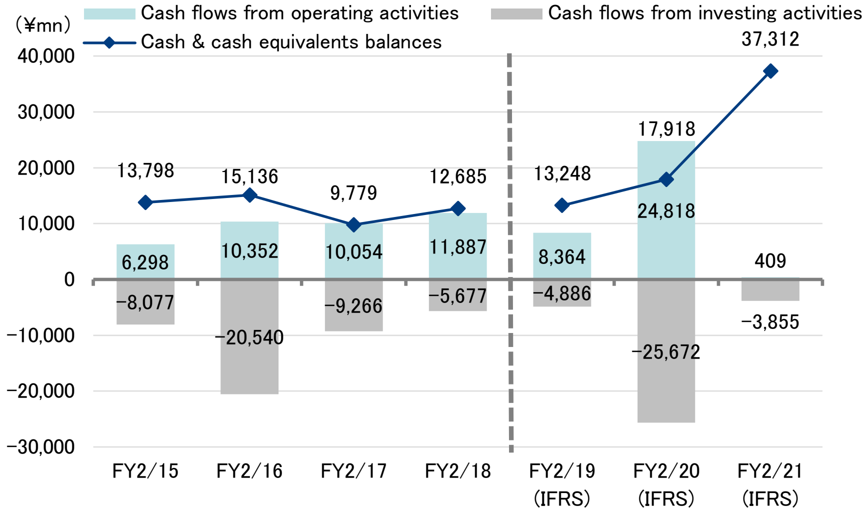
Date acquired	Company name	Main brand(s)	Acquisition price (¥mn)
April 2013	SFP Dining	ISOMARU SUISAN, Toriyoshi Shoten, etc.	6,573
April 2013	eatwalk	AWkitchen, Yasaiyamei, etc.	858
April 2014	YUNARI	Tsukemen TETSU, etc.	1,506
November 2014	Shanghai Bishoku Chushin	Nanxiang Mantou Dian	180
June 2015	KR Food Service	Kagonoya, etc.	14,979
August 2015	RC Japan	Rain Forest Café, etc.	65
January 2018	Route 9g	Hainan Jeefan Restaurants	Undisclosed
March 2018	Create Bayside	Opening restaurants, etc., at IKSPIARI	Undisclosed
December 2018	YUZURU	Gomasoba YUZURU	Undisclosed
March 2019	Kiya Foods	Ginza Kiya	Undisclosed
March 2019	Joh Smile (M&A by SFP)	Maekawa Suigun, etc.	Undisclosed
July 2019	CLOOC DINING (M&A by SFP)	Karaage Center, etc.	Undisclosed
September 2019	create sports and leisure	Operation of golf course restaurants	5,884
September 2019	Il Fornaio (America) LLC	Il Fornaio (North America), etc.	8,050
October 2019	Icchou	ICCHOU, etc.	7,010

* This is the Il Fornaio (America) LLC acquisition price converted at ¥107/$.
Source: Prepared by FISCO from Company materials

From a financial perspective, the equity ratio, which represents the stability of the financial foundation, achieved a level exceeding 35% by FY2/12. Mitsubishi Corporation's shares were acquired by way of TOB, and as a result of around 80% of those shares being retired, the equity ratio declined to 19.7% at end-FY2/13. In FY2/14, equity was strengthened through the sale of treasury shares and the equity ratio improved to 32.4% temporarily at the end of FY2/15 due to a new share issuance in line with the listing (subsidiary listing) of SFP Dining. The equity ratio dropped again to 24.1% at end-FY2/16 with the acquisition of KR Food Service. Since the Company subsequently carried out major acquisitions, such as Icchou and Il Fornaio, and adopted IFRS accounting (changes the lease accounting standard), equity ratio attributable to owners of parent (corresponds to the equity ratio) was 10.8% at end-FY2/20. In FY2/21, the Company maintained the equity ratio at roughly the same level as the end of the previous fiscal year, despite pandemic impact, by procuring funds with perpetual subordinated loans.

In cash flow trends, while cash flows from investing activities steadily exceeded cash flows from operating activities during FY2/14-16 because of aggressive new store openings and M&A activity, these additions fueled earnings growth. The Company temporarily lowered investment cash flow through curtailment of new openings and other measures during FY2/18-19, but then substantially expanded it with multiple M&A deals in FY2/20. In FY2/21, while pandemic impact caused declines in cash flow from operating activities and cash flow from investing activities, "cash and cash equivalents" expanded significantly on financing through perpetual subordinated loans.

Cash flows from operating activities and cash flows from investing activities, cash & cash equivalents balances



Source: Prepared by FISCO form the Company's financial results

Results slumped substantially in FY2/21 due to the COVID-19 pandemic
Though some success in strengthening the income structure and improving the financial foundation

2. FY2/21 results overview

The Company reported FY2/21 results (IFRS standards) with ¥74,425mn in revenue (-46.6% YoY) a ¥14,181mn operating loss, a ¥15,021mn loss before tax, and a ¥13,874mn net loss attributable to owners of the parent, slumping significantly due to COVID-19 impact. Nevertheless, it booked ¥5,130mn in adjusted EBITDA, a key indicator. Revenue and income levels missed revised guidance (disclosed on January 14).

* Adjusted EBITDA = Operating profit + other operating expenses – other operating revenue (excluding cooperation funds, employment adjustment grants, and rent exemptions, etc.) + depreciation expenses + non-recurring expense items

Revenue dropped sharply in all categories due to repeated implementation of suspensions and shorter business hours related to the pandemic. Results fell substantially in 1Q because of uniform suspensions and shortened business hours during the first state of emergency declaration. Activity recovered temporarily from 2Q thanks to incremental resumption of normal operations and return of customer traffic. However, partial suspensions and shortened business hours related to the third COVID-19 wave caused a slowdown in 4Q (refer to the related graph). In particular, extension of the second state of emergency declaration deadline* caused the shortfall in operating profit versus revised guidance (disclosed on January 14, 2021).

* Extended from the initial deadline of February 7 until March 21

Looking at quarterly trends in real same-store sales* (refer to related charges on page 13), revenue fell sharply to 27.8% of the year-ago level in 1Q because of suspensions of many stores under the first state of emergency declaration, and while it steadily recovered in 2Q after the government lifted its state of emergency, shortened business hours accompanying the second pandemic wave from late July limited quarterly revenues to just 51.6% of the previous year. In 3Q, revenue rebounded to 67.5% on resumption of normal operations and the GoTo Eat Campaign effect. The 4Q result, however, weakened again to 46.8% due to the second state of emergency declaration prompted by the third pandemic wave and its extension.

* Calculated including suspended outlets

The Company only opened 68 new outlets in FY2/21 even with 62 openings based on existing contracts in 1H. Meanwhile, it closed 143 outlets during the year, including 55 unprofitable locations, mainly in the izakaya category, in 4Q. These actions built the foundation for improved income (profitability) in the future.

In income, even though the Company implemented rigorous cutbacks in fixed costs (reducing personnel expenses, negotiating rent reductions and exemptions, etc.) and received employment adjustment subsidies and other funds from the government, it posted a massive operating loss because of a heavy fixed cost burden amid sharp decline in revenue. At the quarterly level, despite the attainment of an operating profit in 3Q during a temporary recovery in revenue, hefty decline in 1Q and expanded closure-related expenses in 4Q squeezed profits. In adjusted EBITDA, meanwhile, the Company sustained a positive result other than in 1Q and realized incremental reduction of the breakeven point (adjusted EBITDA basis) through extensive cutbacks in fixed costs*. Main reasons for the shortfall in operating profit versus revised guidance (from January 14) were 1) shortfall in revenue, 2) delays in payment and recording of funds for cooperating with shortened business hours from local governments, 3) recording of losses related to outlet closures, and 4) recording of impairment losses. Given these points, they can be evaluated as contributing to improved profit and loss in the future, with 2) a positive factor for FY2/22 (about ¥2.1bn), and also 3) and 4).

* Breakeven-point revenue (adjusted EBITDA basis) declined to ¥15.5bn in 4Q (58.5% of the previous year).

In financial conditions, gross asset value expanded 7.8% YoY to ¥161,966mn, despite shrinkage of fixed assets on reduced outlet volume and other factors, thanks to substantial build-up of cash and deposits on cost cutbacks, bank loans, and major fund-raising (¥15bn) with a perpetual subordinated loan* in response to the COVID-19 pandemic impact. Equity, meanwhile, increased 5.2% YoY to ¥17,052mn, even with negative impact from booking a net loss, on improvement of the financial foundation with the perpetual subordinated loan, and equity ratio attributable to owners of the parent held at roughly the same level as the previous year-end at 10.5% (vs. 10.8% in FY2/20). With a ¥6bn commitment line in addition to cash and deposit holdings (¥37.3bn), the Company continues to possess sufficient funding soundness to withstand a period of instability.

* This type of loan has less priority than general credits in the repayment priority order and lacks voting rights and a repayment deadline. Under IFRS, subordinated loans are booked in capital as an "equity instrument."

Overview of FY2/21 results

(¥mn)

	FY2/20		FY2/21		Change		FY2/21 Revised forecasts (dated Jan. 14, 2021)		
	Results	% of total	Results	% of total	Amount	%	Amount	% of total	Difference
Revenue	139,328	100.0%	74,425	100.0%	-64,902	-46.6%	77,000	100.0%	-2,574
CR Category	51,843	37.0%	27,253	36.2%	-24,590	-47.4%	28,000	35.9%	-746
SFP Category	40,216	28.7%	17,428	23.1%	-22,787	-56.7%	18,500	23.7%	-1,071
Specialty Brand Category	39,198	28.0%	25,542	33.9%	-13,655	-34.8%	26,300	33.8%	-757
Overseas Category	8,962	6.4%	5,146	6.8%	-3,816	-42.6%	5,100	6.5%	46
Adjustment	-893	-	-945	-	-52	-	-900	-	-45
Operating profit (loss)	3,378	2.4%	-14,181	-	-17,559	-	-9,200	-	-4,981
Profit (loss) before tax	3,012	2.2%	-15,021	-	-18,033	-	-9,800	-	-5,221
Profit (loss) attributable to owners of parent	1,205	0.9%	-13,874	-	-15,079	-	-8,400	-	-5,474
Adjusted EBITDA	25,212	18.1%	5,130	6.9%	-20,081	-79.7%	6,860	8.9%	-1,729
CR Category CF	5,992	11.6%	-1,374	-	-7,366	-122.9%	-1,360	-	-14
SFP Category CF	4,532	11.3%	-2,095	-	-6,628	-146.2%	-1,580	-	-515
Specialty Brand Category CF	2,921	7.5%	-329	-	-3,251	-111.3%	200	-	-529
Overseas Category CF	1,173	13.1%	-494	-	-1,668	-142.1%	-420	-	-74
Adjustment	10,591	-	9,424	-	-1,167	-11.0%	10,020	-	-595

* The percentages of the total for the category CF (cash flow) are from the percentages of sales per category.
* Category cash flow = Operating profit (Japan GAAP) + depreciation expenses + amortization of goodwill + + sponsorship income + non-recurring expense items + limited-time earnings items (employment adjustment subsidy, etc.)
Source: Prepared by FISCO from Company materials

Financial position at end-FY2/21

(¥mn)

	as of the end of February 2020	as of the end of February 2021	Change	
			Amount	%
Total asset	150,317	161,966	11,649	7.8%
Equity attributable to owners of parent (equity)	16,216	17,052	836	5.2%
Equity ratio attributable to owners of parent (equity ratio)	10.8%	10.5%	-0.3pt	-
Interest-bearing debt	101,624	119,033	17,409	17.1%
Corporate bonds and loans	49,774	70,265	20,491	41.2%
Lease liabilities	51,850	48,768	-3,082	-5.9%

Source: Prepared by FISCO form the Company's financial results

The numbers of outlet openings, exits, etc.

	as of the end of February 2020	New openings	Closures	Transfers, etc. (adjusted)	as of the end of February 2021	Brand conversions
CR Category	569	41	67	+10	553	22
SFP Category	275	5	53		227	8
Specialty Brand Category	251	18	18	-8	243	0
Overseas Category	54	4	5		53	0
Total number of group outlets	1,149	68	143	+2	1,076	30

Total number of outlets for the entire Group including business consignment outlets and FC outlets
Source: Prepared by FISCO from Company materials

Category results are set out as below.

(1) CR Category

Revenue declined 47.4% YoY to ¥27,253mn, and category cash flow* had a ¥1,374mn deficit (vs. a ¥5,992mn surplus in FY2/20). While it fell substantially in 1Q due to suspension of many outlets linked to commercial facilities and other sites in the first state of emergency declaration, cash flow sustained a surplus from 2Q thanks to resumption of normal operations, format changes (22 stores), and rent reductions and exemption negotiations. This business had 553 outlets at the end of FY2/21 based on 41 openings, which consisted of 26 booths at food courts (or food halls) that already had contracts and new additions in "shabu shabu" and dessert formats, and 67 closures.

* Category CF (cash flow) utilizes adjusted EBITDA (operating profit + other operating expenses – other operating revenue including excluding funding revenue + depreciation expenses + non-recurring expense items) (same below).

(2) SFP Category

Revenue declined 56.7% YoY to ¥17,428mn, and category cash flow had a ¥2,095mn deficit (vs. a ¥4,532mn surplus in FY2/20). It was down significantly in 1Q due to uniform suspensions in the first state of emergency declaration and stalled in 2Q as well on shortened business hours adopted in response to the second pandemic wave. Despite temporary recovery in 3Q when normal business resumed, activity slowed in 4Q because of the impact of the third pandemic wave. Since mainstay ISOMARU SUISAN uses an income model that leverages strength of 24-hour operation at locations near train stations and in shopping districts, restrictions on people movement and shortened business hours heavily affected results. Based on recovery in 3Q when normal business resumed, the format itself retained advantages. Additionally, this business took steps to reinforce income operations with closures of unprofitable outlets and format conversions (8 stores) and expansion of takeout and delivery services. It had 227 outlets at period-end based on curtailment of new openings to 5 outlets and exits from 53 outlets mainly by closing unprofitable sites.

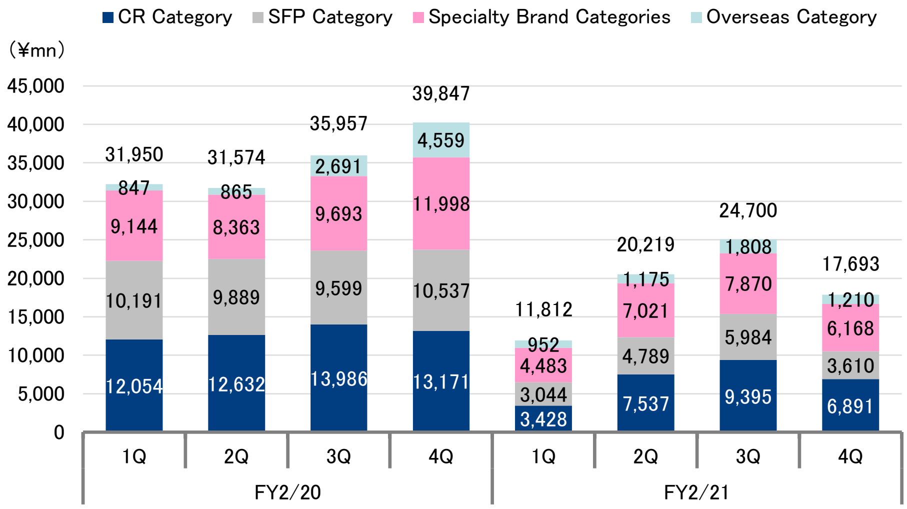
(3) Specialty Brand Category

Revenue declined 34.8% YoY to ¥25,542mn, and category cash flow had a ¥329mn deficit (vs. a ¥2,921mn surplus in FY2/20). This business held up reasonably in 1Q, despite stay-home restrictions, thanks to its strength as a daily brand in tsukemen, soba noodle, and bakery formats. From 2Q, it sustained positive cash flow on recovery trends at suburban roadside outlets in regional and urban areas. Period-end outlets count was 243 outlets based on 18 new openings and 18 closures.

(4) Overseas Category

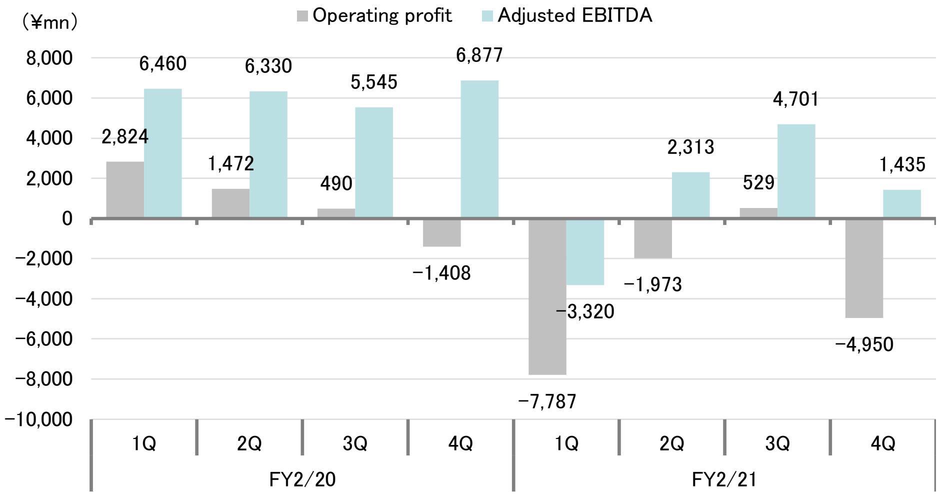
Revenue declined 42.6% YoY to ¥5,146mn, and category cash flow had a ¥494mn deficit (vs. a ¥1,173mn surplus in FY2/20). This business incurred setbacks suspension of all outlets due to lockdowns in North America and Singapore in 1Q. However, operations in Taiwan and Hong Kong were solid thanks to relatively modest the COVID-19 pandemic impacts. While activity recovered on resumption of business in Singapore and incremental reopening in North America, delayed payment of subsidies related to administration change in the US affected 4Q. Period-end outlets count was 53 outlets based on 4 new openings and 5 closures.

Quarterly trends in category revenue



Note: Does not include other adjustment value
Source: Prepared by FISCO from the Company's results supplemental briefing materials

Quarterly trends in operating profit and adjusted EBITDA



Source: Prepared by FISCO from the Company's results supplemental briefing materials

(Real) same-store sales (YoY) by category

	1Q	2Q	3Q	4Q	Full year
CR Category	22.9%	50.7%	67.6%	54.5%	48.6%
SFP Category	28.3%	47.4%	65.0%	39.2%	47.6%
Specialty Brand Categories	35.9%	59.4%	73.9%	51.2%	54.8%
Overseas Category	20.0%	32.3%	45.1%	28.6%	31.5%
Companywide	27.8%	51.6%	67.5%	46.8%	48.5%

Source: Prepared by FISCO from the Company's results supplemental briefing materials

3. Overview of FY2/21

As explained above, the Company had tough results in FY2/21, in contrast to previous sustained growth, because of a major setback in business due to COVID-19 impact and massive losses, similar to peers. Nevertheless, it achieved progress toward prompt recovery and renewed growth by quickly lowering the breakeven point with rigorous cost controls and improving the financial foundation, including securing sufficient liquidity. While COVID-19 impact generally undermined results, it is important to monitor modest differences depending on the category (or business format) and store location (in the Tokyo metropolitan area or regional areas and in the city center or suburbs in the Tokyo metropolitan area). In other words, the ability to make optimal choices and resource allocations while considering characteristics and possibilities in laying groundwork for prompt recovery and dealing with changes in the environment offers an opportunity for renewed awareness of the Company's strength in having built a distinctive business portfolio.

Results with activities during the COVID-19 pandemic

Revising business formats and offering takeout and delivery services to address changes in the environment

1. Implemented cost controls

In outlet personnel expenses, the Company implemented temporary layoffs (with a layoff allowance) of employees at outlets that suspended operations. It also received employment adjustment subsidies (totaling about ¥6.8bn) and carried out rigorous shift controls. In rent, it realized about ¥2.3bn in savings through negotiations for reductions and exemption with facility owners and reduction of the sales commission rate. Furthermore, it sought to narrow losses and transition to an income structure that generates profits even at low revenue through cutbacks in headquarter expenses, voluntary return of director compensation, mergers of group companies*1, and establishment of a new company to handle shared service functions*2.

*1 Reorganization of five companies added to the group through past M&A deals to two companies (as of September 1, 2020)
*2 Established a joint venture with SFP Holdings <3198> to handle shared services for accounting, personnel, and other corporate services (as of September 1, 2020)

2. Revised business formats

The Company actively revised business formats (30 outlets) in response to changes in usage scenarios during the COVID-19 pandemic. Specifically, it converted buffet stores that could not operate effectively in the pandemic to cheese dish or "shabu shabu" outlets popular with women or food halls leveraging the large outlet space. In particular, the ability to continue openings with format changes amid strong requests from commercial facility owners appears to be an effective bargaining point in rent negotiations. The Company also adjusted izakaya pub sites to delivery-only specialty formats, collaborative sites with existing outlets (co-location), and restaurants and sushi shops that target daily use depending on the location environment.

3. Initiatives with takeout and delivery services

The Company steadily expanded takeout and delivery services tailored to locations and formats for the purpose of flexibly responding to lifestyle and preference changes spurred by COVID-19. It started a delivery specialty format too that utilizes kitchens for existing outlets.

Results outlook

Targeting profits in FY2/22 on revenue recovery and enhanced profitability

1. FY2/22 outlook

In FY2/22 guidance, the Company targets ¥115,000mn in revenue (+54.5%), ¥4,600mn in operating profit, ¥4,000mn in profit before taxes, and ¥2,500mn in profit attributable to owners of the parent. It expects profitability at all income levels driven by recovery in revenue. Furthermore, it anticipates strong recovery in adjusted EBITDA, a key indicator, to ¥22,000mn.

Despite a difficult start in 1Q due to the third state of emergency declaration, the Company forecasts moderate recovery in revenue from 2Q. Due to lifestyle changes, however, it assumes that consumption behavior should not fully return to the same level as previously and projects real same-store sales for the full year at 76.4% of the level prior to the COVID-19 pandemic (FY2/20). In outlet trends, as response to changes in the environment related to the pandemic, it intends to continue shifting from “urban areas and locations attracting customers” to “suburban areas, daily locations” and “special-purpose formats” to “daily-use formats.” The FY2/22 plan envisions 6 openings and 11 closures and pursuit of format changes and expanded takeout and delivery services.

In income, it intends to cover losses from 1Q, which is facing difficult conditions, with employment adjustment subsidies and funds from local governments for cooperating with shortened business hours* and build operations capable of generating profits even with moderate recovery in revenue through conversion to a lean income structure via continued rigorous cost controls and cutbacks in rent and other fixed costs, and we forecast a return to a profitable status.

* The Company estimates ¥3.5bn in employment adjustment subsidies and funds from local governments for cooperating with shortened business hours through March, including the above-mentioned postponed portion from the previous fiscal year (about ¥2.1bn).

FY2/22 outlook

(¥mn)

	FY2/21 results		FY2/22 results		Change	
	Amount	% of total	Amount	% of total	Amount	%
Revenue	74,425	100.0%	115,000	100.0%	40,575	54.5%
CR Category	27,253	36.2%	43,700	37.6%	16,447	60.3%
SFP Category	17,428	23.1%	25,000	21.5%	7,572	43.4%
Specialty Brand Categories	25,542	33.9%	36,100	31.0%	10,558	41.3%
Overseas Category	5,146	6.8%	11,500	9.9%	6,354	123.5%
Adjustment	-945	-	-1,300	-	-355	-
Operating profit	-14,181	-19.1%	4,600	4.0%	18,781	-
Profit before taxes	-15,021	-20.2%	4,000	3.5%	19,021	-
Profit attributable to owners of the parent	-13,874	-18.6%	2,500	2.2%	16,374	-
Adjusted EBITDA	5,130	6.9%	22,000	19.1%	16,870	328.8%
CR Category CF	-1,374	-	5,500	12.6%	6,874	-
SFP Category CF	-2,095	-	2,100	8.4%	4,195	-
Specialty Brand Category CF	-329	-	3,200	8.9%	3,529	-
Overseas Category CF	-494	-	1,300	11.3%	1,794	-
Adjustment	9,424	-	9,900	-	476	5.1%

* Category cash flow share indicates the level versus category revenue.
* Category cash flow = Operating profit (Japan GAAP) + depreciation expenses + amortization of goodwill + + sponsorship income + non-recurring expense items (employment adjustment subsidy, Subsidy for cooperation of shorten operating hours by each local government, etc.)
Source: Prepared by FISCO from Company materials

2. FISCO view

FISCO thinks it is important to continue monitoring the COVID-19 pandemic impact, but believes the Company's revenue outlook is sufficiently attainable once normal business resumes from 2Q. While the earnings outlook seems ambitious at first glance, it should be within reach too via attainment of the revenue target considering 1) contribution from shortened business hour funds, including the delayed portion from the previous fiscal year (about ¥2.1bn) and 2) reduction of the breakeven point via reinforcement of the income structure. Due to continued lack of visibility about the pandemic trend, the revenue outlook needs to be viewed with strong uncertainty. Nevertheless, even if revenue undershoots because of ongoing shortened business hours, additional cooperation funds are likely to limit earnings shortfall.

Future direction

Disclosure of the transition to a new management framework along with a change in President
Intends to promote development of core capabilities for renewed growth for the time being

1. Transitioning to a new management framework along with a change in President

The Company announced the transition to a new management structure along with a change in the President on April 1, 2021 (it officially approved the new format at the ordinary general meeting of shareholders held on May 27, 2021). Since the establishment of the company in 1999, Haruhiko Okamoto, the current president, has been promoting the “Multi-Brand, Multi-Location Strategy” based on the management philosophy of “Speed, Creativity, Challenge” to develop and expand various types of brands suited to individual locations. He also led the shift to “Group Federation Management” that aims for growth as a group that consists of a variety of corporate culture. Amid efforts to suitably time the change the president, he concluded that now is the right moment to work on building a business model for the future that flexibly responds to changes in the environment (new normal) spurred by the COVID-19 pandemic. Progress in developing a suitable response to pandemic conditions through conversion to a lean cost structure and improvement of the financial foundation support the decision. Jun Kawai, the candidate for the new president, worked under President Okamoto since 2003 to establish the management system, prepare for the IPO, promote M&A, and develop global business. He recently handled management of the Overseas Department and Financial Planning Department as Executive Managing Director.

2. Future direction

While the Company previously disclosed a three-year medium-term management plan annually, it postponed disclosure this time because of uncertainty about the COVID-19 pandemic impact. It should announce the future management policy and other points following the official start of the new regime (after the ordinary general meeting of shareholders). For the time being, meanwhile, it appears to be largely sticking with the stance of assessing the content and timing of investments seeking renewed growth from FY2/23 once it has strengthened core profitability and developed its foundation.

3. FISCO’s focus points

FISCO sees the strategic theme for the time being as transitioning to an income structure capable of generating profits even if revenue does not fully return to the previous level through cost cutbacks, revision of resource allocation, and building a new business model. If this is accomplished, we expect changes in the environment involving industry reorganization to broaden the Company’s growth opportunities. We also anticipate positive effect from accelerated collaboration within the group and synergy creation with the transition as a catalyst, as evidenced by the establishment of a shared services company. Management prowess under the new framework is a key factor in determining how to overcome this challenging period and build a foundation for sustainable growth after the situation settles down and which areas should continue and which ones require change.

Shareholder returns

Cancelled the dividend in FY2/21 because of the COVID-19 pandemic-related losses
Undecided on interim and period-end dividends in FY2/22 at this point

The Company decided to cancel the dividend in FY2/21 because of pandemic-related losses. It also has an undecided stance on interim and period-end dividends in FY2/22 at this point because of a lack of clarity. Regarding the shareholder benefit program, meanwhile, it views this as an important shareholder return measures and plans to continue the program.

Disclaimer

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